

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }  
BOCA CHINO CORPORATION )

Appearances:

For Appellant: Robert A. Schlesinger  
Attorney at Law

For Respondent: Kendall E. Kinyon  
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Boca Chino Corporation against proposed assessments of additional franchise tax in the amounts of \$3,162.47, \$4,042.94 and \$4,091.00 for the income years ended February 28, 1973, 1974 and 1975, respectively.

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The issue presented for determination is whether income from municipal, state and federal bonds which are exempt from taxation for income tax purposes may be included in gross income for the purpose of measuring franchise tax.

Appellant **was** incorporated in California in 1957. Its principal business activity was listed as "**investments.**" On each of appellant's franchise tax returns for the appeal years, it omitted from computation of gross income the interest received from municipal, state and federal bonds. Respondent audited the returns and issued a proposed deficiency assessment for each of the years which reflected the inclusion of the interest income in appellant's gross income. Appellant objected to respondent's action and this appeal followed.

Interest income from municipal, state and federal bonds is exempt from taxation for income tax purposes. Respondent takes the position that such income, nevertheless, can be included in gross income for the purpose of measuring franchise tax. It notes that section 24272 of the Revenue and Taxation Code specifically provides that for the purposes of the franchise tax imposed under Chapter 2, "gross income" includes all interest received from federal, state, municipal or other bonds. Respondent further points out that its position was upheld by the United States Supreme Court in Pacific Co., Ltd. v. Johnson, 285 U.S. 480, 76 L. Ed. 893 (1932), 212 Cal. 148, 29 Cal. 2d 489.) Pacific Co. held that there could be included in the measure of the California Bank and Corporation Franchise Tax interest from improvement district bonds, even though it be assumed that such was immune from taxation under the state Constitution.

We must agree with respondent that case law supports its position. (See Flint v. Stone Tracy Co., 220 U.S. 107 [55 L. Ed. 3891 (1911)] and Educational Films Corp. v. Ward, 282 U.S. 379 [75 L. Ed. 4001 (1931)]; see also, Security-First National Bank of Los Angeles v. Franchise Tax Board, 55 Cal. 2d 407, 359 P.2d 625 (1961).) In Appeal of Reclaimed Island Lands Company, decided on November 15, 1939, this board-wed case precedent, and held that the Bank and Corporation Franchise Tax Act does not impose a direct tax upon income, but imposes instead a tax upon the privilege of doing business in corporate form; the tax for each year being measured by the net income of the corporation during the preceding year. This holding clearly establishes the propriety of respondent's action in the instant matter.

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Appellant's argument is that it is unconstitutional to include in gross income the interest which would otherwise be tax exempt. With respect to this contention, we believe the passage of Proposition 5 by the voters on June 6, 1978, adding section 3.5 to article III of the California Constitution, precludes our determining that the statutory provisions involved are unconstitutional or unenforceable. Moreover, this Board has a well established policy of abstention from deciding constitutional questions in appeals involving proposed assessments of additional tax. (Appeal of Maryland Cup Corp., Cal. St. Bd. of Equal., March 23, 1970; Appeal of Paul Peringer, Cal. St. Bd. of Equal., Dec. 12, 1972.) This policy is based upon our belief that such questions are entitled to judicial scrutiny, and the absence of any specific statutory authority which would allow the Franchise Tax Board to obtain judicial review of an adverse decision. Although this abstention policy applies in this case, we nevertheless note that the aforementioned cases affirm the constitutionality of the tax and appear to render appellant's argument meritless.

Subsequent to the filing of this appeal, respondent discovered that it erroneously included \$525.00 interest income from savings and loan institutions in the proposed assessment for the income year ended February 28, 1975. Therefore, the proposed assessment for that year should be reduced to \$4,044.18. In all other respects, the action of the Franchise Tax Board is sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Boca Chino Corporation against proposed assessments of additional franchise tax in the amounts of \$3,162.47, \$4,042.94 and \$4,091.00 for the income years ended February 28, 1973, 1974 and 1975, respectively, be and the same is hereby modified in order to reflect respondent's erroneous inclusion of \$525.00 interest income from savings and loan institutions in the proposed assessment for the income year ended February 28, 1975, and that the amount of the proposed assessment for that year be reduced to \$4,044.18 to reflect such change. In all other respects, the action of the Franchise Tax Board is hereby sustained.

Hubert Leon, Chairman  
 Ernst Mronburg, Member  
 Ned Kessler, Member  
 William H. Burnett, Member  
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